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QUORSUS

Regulatory Reporting Newsletter

INTRODUCTION

Hello and welcome to the latest edition of the Quorsus Regulatory Reporting Newsletter. In this issue our experts take a closer look at two key areas of interest for firms: delegated reporting and the Common Domain Model. Both subjects will likely require assessment and investment decisions from market participants in the near future.

In addition to this, the newsletter touches upon updates in Europe and the UK with SFTR, and in North America with the much-awaited announcement from the CFTC regarding the new compliance date for the Rewrite.

Newsletter Terminology

- **ANE** Arranged, Negotiated or Executed
- **APAC** Asia-Pacific
- **ASIC** Australian Securities and Investments Commission
- **CCP** Central Clearing Counterparty
- **CDE** Critical Data Elements
- **CDM** Common Domain Model
- **CFTC** Commodity Futures Trading Commission
- **CM** Confirmation Mechanism
- **CPMI** Committee on Payments & Market Infrastructure
- **IOSCO** International Organization of Securities Commissions
- **DSB** Derivative Services Bureau
- **EMIR** European Market Infrastructure Regulation
- **ESMA** European Securities & Markets Authority
- **FCA** Financial Conduct Authority
- **HKMA** Hong Kong Monetary Authority
- **ISO** International Organisation of Standardisation
- **ITS** Implementing Technical Standards
- **JFSA** Japan Financial Services Agency
- **LEI** Legal Entity Identifier
- **MAS** Monetary Authority of Singapore
- **MiFIR** Markets in Financial Investment Regulation
- **PPD** Public Price Dissemination
- **REFIT** Regulatory Fitness & Performance Program
- **RTS** Regulatory Technical Standards
- **SDR** Swap Data Repository
- **SEC** Securities Exchange Commission
- **SFTR** Securities Financing Transactions Regulation
- **TR** Trade Repository
- **TRACE** Treat Relief & Compliance Enhancement
- **UPI** Unique Product Identifier
- **XML** Extensible Markup Language

WHAT'S INSIDE THIS ISSUE:

Delegated Dilemma *- Increasing regulatory requirements and a raft of upcoming changes could make this the ideal time for firms to assess their reporting models. The delegated approach may work for some, but for others self-reporting will always have its advantages*

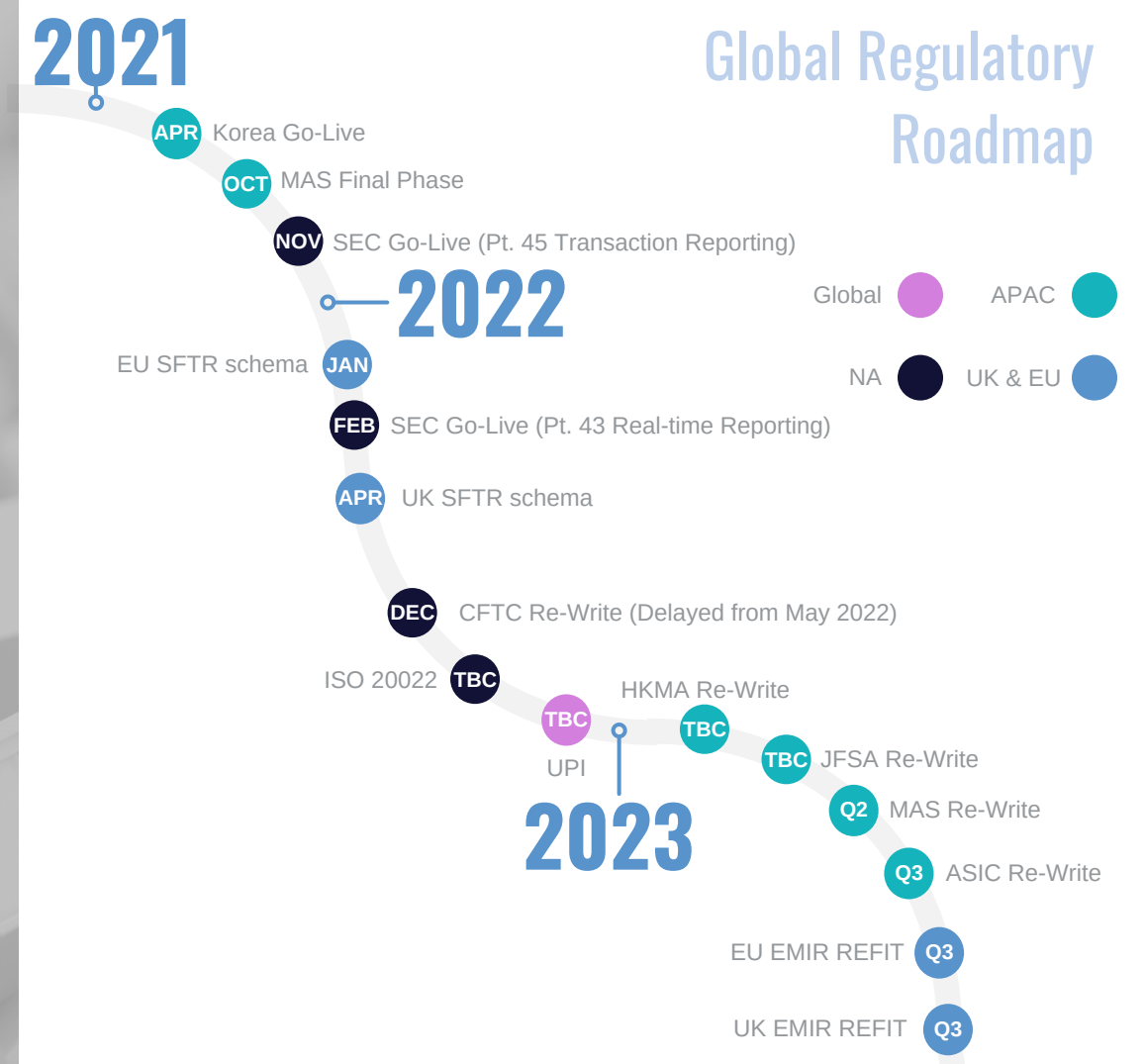
OTC Derivatives Common Domain Model *- Each passing week takes us closer to the completion of a Common Domain Model language which promises to enhance the accuracy of risk management, drive more efficient processes and also improve the effectiveness of controls for market participants. Nevertheless, these advantages must be balanced against several other key factors*

SFTR *- Update on UnaVista's SFTR Trade Repository closure as well as from ESMA and the FCA*

CFTC *- The announcement of the much-awaited delay to the compliance date of the CFTC Rewrite*

WHO WE ARE

Quorsus provides consultancy services to financial institutions facing a range of challenges and constraints across the post-trade landscape. We offer **unparalleled expertise in post-trade technologies, operations, regulatory solutions, and market infrastructure, helping our clients to achieve their goals through intelligent reengineering of platforms and process**. We pride ourselves on the strength and character of our consultants. This, combined with decades of industry expertise, ensures that our clients meet their objectives, however steep the challenge.



EUROPE - THE DELEGATED DILEMMA

THE DILEMMA OF WHETHER TO DELEGATE OR NOT IS FURTHER COMPLICATED BY THE UNCERTAINTY OF WHAT FURTHER CHANGES TO THE REPORTING REQUIREMENTS WILL ARISE IN THE FUTURE

Background

Increasing regulatory expectations and a slew of upcoming changes make this a perfect time to assess your reporting model, write David Brown and Andrew Pinnington-Mannan.

Delegated reporting - the act of a counterparty or service provider submitting trade reports on behalf of another counterparty - has been an integral part of European derivatives reporting regimes since its inception. The concept was introduced as part of EMIR in 2014, with similar provisions emanating as part of the recent SFTR go-live.

There are myriad issues for firms to consider when assessing whether to delegate their reporting, including weighing up the maintenance of robust oversight programs for delegated models versus the costs and resources of maintaining self-reporting capabilities.

The dilemma of whether to delegate or not is further complicated by the uncertainty of what further changes to the reporting requirements will arise in the future. There have already been various iterations since its inception and both the EMIR and SFTR regimes have changes on the horizon.

THE DELEGATED DILEMMA (CONT.)

Impact of Upcoming Regulation on Delegated Services

Providers of delegated services often do so reluctantly, and for free, in order to maintain their client execution or prime brokerage business. This often results in service levels that fall below the demands of clients, who are ultimately responsible for the reports submitted to trade repositories and liable for any erroneous reporting fines.

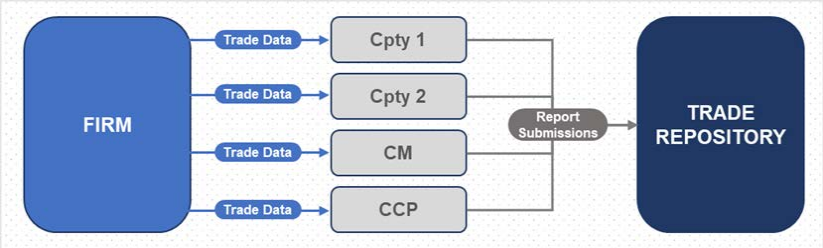
EMIR REFIT, due in 2023, is likely to further increase client demands for high quality data and a higher level of responsiveness when issues occur. The recent EU consultation paper suggests that delegated providers should inform their clients whenever data quality issues occur, a significant departure from the current delegated reporting model, which relies on clients raising issues to their brokers, service providers and counterparties.

Some sell-side firms will no doubt struggle to meet these expectations; however others that we have spoken to are considering significant investment in their delegated reporting service to create a competitive advantage, mindful of the fact that many buy-side firms now include reporting performance in their broker scorecards and thus allocation decisions. On the other hand, some firms are actively considering whether to continue providing it in the context of increased expectations from clients and regulators alike.

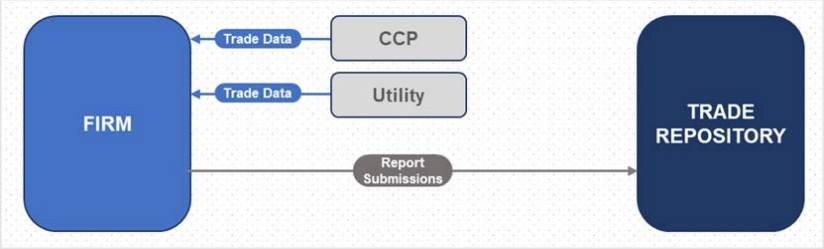
What is the best operating model for your business?

At a high level, there are three different types of operating models that firms with reporting obligations can follow:

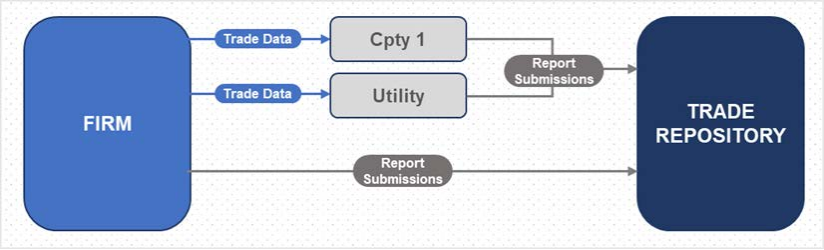
1. Delegated - All reporting delegated to third party:



2. Self-Reporting - Capability designed to report all applicable trades and events from in-house architecture:



3. Hybrid - Self-reporting capability for some transactions and delegation of specific flows or products to counterparties or third party providers:



PROVIDERS OF DELEGATED SERVICES OFTEN DO SO RELUCTANTLY, AND FOR FREE, IN ORDER TO MAINTAIN THEIR CLIENT EXECUTION OR PRIME BROKERAGE BUSINESS

DELEGATED DILEMMA (CONT.)

Benefits, Challenges and Risks of each Operating Model

The best operating model for each firm will depend on their investment capacity, the service they are looking to provide to their clients and the business risk appetite. Quorsus has analysed the benefits, challenges and risks for each operating model to help clients think about the operating model that best suits their needs.

The table below shows a brief summary of our analysis.

	BENEFIT	CHALLENGES	RISKS
FULLY DELEGATED	▪ Development costs should be lower than building self-reporting capability ▪ Impact of changes in reporting requirements will be mostly borne by the reporting provider ▪ Reduced number of pairing and matching breaks in dual sided jurisdictions ▪ Reduced data sets required to be maintained in architecture	▪ High legal set up costs for completing the Delegated Reporting Agreements (DRA's), which are weighted in favour of the provider and only commit to reporting on a best effort basis ▪ Reference data has to be supplied to the delegated party and processes set up for the onboarding of new clients ▪ Self-reporting capability may be required for products not supported by a provider, resulting in a complex operating model ▪ Difficulty in retrieving data in the event of a regulatory audit or inquiry	▪ Reporting provider may exit service provision at short notice. ▪ Low control over reporting accuracy or error correction, increasing risk of breaching regulatory requirements ▪ Robust oversight program required to ensure accuracy of reporting ▪ No choice of trade repository
SELF-REPORTING	▪ Single operating model can be implemented with desired workflow tools and minimal manual processes ▪ Capability can be built in accordance with existing data architecture ▪ Preventative controls can be built into data model and configured according to risk appetite ▪ Not susceptible to third party or delegated providers exiting service ▪ Adequate controls can lower risk or inaccurate reporting and regulatory breaches ▪ Option to report to any trade repository	▪ Initial costs can be high depending on the scope of required development ▪ IT resources required for maintenance of utilised systems ▪ Data sourcing may be challenging where gaps exist in internal data; brokers will often send clearing statements/regulatory data in differing formats and require their client to normalise it	▪ Ongoing development costs for changes in regulatory required when regulatory amendments are implemented
HYBRID	▪ Self-reporting capability complimented by third party provider(s) allowing the reporting of particular instruments after electronic confirmation, clearing etc ▪ Use of third party provider may reduce internal data sourcing requirements ▪ Cost of adapting model for changes in reporting requirements will be shared with the reporting provider	▪ Similar development costs as creating self-reporting capability ▪ Creates split operating model to accommodate both self-reporting and delegated reporting ▪ New data requirements may be needed for gaps in current architecture ▪ Controls required to ensure full capture of all eligible accounts and instruments	▪ Reporting provider may exit service provision at short notice ▪ Low control over reporting accuracy increasing risk of breaching regulatory requirements ▪ Increased reconciliation requirements ▪ Robust oversight program required to determine accuracy of reporting

WHICHEVER MODEL IS CHOSEN, COMPLIANCE TEAMS AND CLIENTS WILL BE SEEKING ASSURANCE AND EVIDENCE OF A TIGHT CONTROL FRAMEWORK

Resolving the Delegated Dilemma

With so many factors in play it is important for firms to start looking now at what strategic operating model will best serve their risk profile and clients, as well as accommodate the raft of upcoming regulatory changes. Sell-side firms have an unenviable choice between removing their delegated reporting services and upsetting their clients, or funding the mandated changes under EMIR Refit and also meeting increasing client demands around error notification and resolution.

Buy-side firms will need to determine if the cost of building self-reporting capabilities is justified to reduce the possibility of reputational and financial risk prevalent in delegating reporting to third parties. Whichever model is chosen, compliance teams and clients will be seeking assurance and evidence of a tight control framework as the financial burden and reputational damage of non-compliance continues to increase. Similarly, the end clients of these investment advisors (whether pension funds or others) continue to exert pressure on them to improve the reporting that is passed through to them.

The dilemma for delegated reporting comes as a result of the need to balance risk appetite, client relationships, investment capacity and regulatory relationships. No matter which way firms decide to go, strong controls are critical. Quorsus is perfectly positioned to help assess your reporting process and make tailored recommendations on which model best suits your firm. Our team comprises experts from across the industry, from people that have managed delegated reporting teams at large investment banks to those that have managed reporting oversight functions on the buy-side. This, combined with our extensive knowledge of trade repositories, puts us in a unique position to help assess and advise on your reporting operating model.

OTC DERIVATIVES - COMMON DOMAIN MODEL

Amy Hsu and Benoit Julia consider the Digital Regulatory Reporting initiative and the journey thus far.

Over the last decade, in response to the 2007/2008 financial crisis, the G20 regulators have mandated ever-increasing levels of trade and transaction reporting. Since the introduction of CFTC and EMIR reporting in 2012 and 2014 respectively, the aim has been to accurately understand and manage the systemic risk created by market participants trading OTC and Exchange-traded derivatives, and to anticipate concentration risk to avoid the development of another financial crisis.

Whilst the quality of transaction reporting has slowly improved over the past decade, complexity in the processes and controls remains due to differing international regulatory requirements and standards. To remain compliant, market participants must rely upon, and invest in, their legal and compliance departments. Inconsistencies in rule interpretation and implementation are common across the market, resulting in poor data quality and preventing a clear view of systemic risk for regulators across the globe.

Consistency Challenges in Trade and Transaction Reporting

Given the challenges in consistently interpreting and implementing regulatory requirements- even for vanilla products- the benefit of mutualising this across the industry is obvious. Since 2018, ISDA has been working on a common data model which seeks to address the challenges that industry participants are facing.

The Common Domain Model (CDM), is a data model that aims to provide a standard representation of derivative products, lifecycle events and trade calculations. There is a clear benefit to applying this framework to the world of regulatory reporting, particularly given regulators are moving towards harmonisation of their reporting attributes with the Critical Data Elements introduced by CPMI-IOSCO.

Proponents of the introduction of CDM believe that there are multiple advantages for the industry:

• A consistent approach and methodology for defining derivative products and events throughout the trade lifecycle, helping to standardise processes and increase efficiency;

• Creating common interpretation and implementation of regulatory rules within the model, including best practice; single interpretation of regulatory rules;

• Reduction of effort and cost of operational implementations, through industry collaboration and agreed standards.

One of the current applications of the CDM is that of improving reporting processes and quality through Digital Regulatory Reporting (DRR). ISDA's initiative, launched in 2021 for CFTC and EMIR, aims to generate regulatory reporting output from CDM, leveraging the common derivative product data model, to standardise the trade and transaction reporting requirement, simplifying and mutualising interpretation across the industry.

WHILST THE QUALITY OF TRANSACTION REPORTING HAS SLOWLY IMPROVED OVER THE PAST DECADE, COMPLEXITY IN THE PROCESSES AND CONTROLS REMAINS DUE TO DIFFERING INTERNATIONAL REGULATORY REQUIREMENTS AND STANDARDS

COMMON DOMAIN MODEL (CONT.)

The major participants of CDM / DRR initiatives are clearing houses and major sell-side firms. These and any additional market participants adhering to the DRR standardised global framework of best practice in collecting and reporting regulatory data, will be able to minimise their reporting breaks and achieve greater consistency in regulatory interpretation and compliance. Although the introduction of CDM and DRR appears to be a clear step forward for the industry, there are some challenges on the way to a truly common domain model:

• Implementation - Firms have built regulatory logic and data normalisation capabilities at large cost; budget holders may see the rise of CDM / DRR as requiring investment to replace technology and code which they have already implemented at a large financial and resourcing cost. Equally, firms must consider whether to implement the CDM directly into their own technology architecture or maintain as a stand-alone testing tool.

• Competing priorities - The investment and resourcing for CDM and DRR implementation will be challenged by significant other requirements in the regulatory reporting space to adapt to imminent regulatory changes.

• Rate of adoption - Whilst clearing houses and the sell side have been actively involved in defining and adopting CDM / DRR, the buy-side has not yet engaged significantly. Whilst there is increasing participation, it requires a broad cross-section of firms (and products) for DRR to provide the benefits it aims to.

• Developing technology - Although the majority of the field-level modelling has been completed for CFTC, the development of technology and code continues to evolve

Modelling in progress, socialisation and adoptions continues

Quorsus is helping to lead the implementation of CDM and DRR across the industry by reaching out to member firms and encouraging their participation in the initiative, as well as helping to manage the CFTC Accelerate initiative.

For the core categories of the CFTC's reportable fields (e.g., notional amount and quantities, payment, price, counterparty etc.), the modelling was mostly completed by the end of 2021. Industry participants and regulators are also currently discussing modelling and standards for an additional set of key fields e.g., Events, Packages etc.

The target to complete the modelling of the remaining CFTC fields is mid-2022. The review and modelling of EMIR fields is being performed in parallel with the CFTC exercise, taking advantage of commonality between regulations. The modelling for APAC obligations will follow in 2023. Another priority for ISDA in 2022 is the integration of CDM into the upcoming messaging standards i.e., XML / ISO20022.

The Opportunity for Additional Efficiency

The migration and adherence to CDM, and compliance to ISO 20022 is mandatory for the EMIR Refit in Q3 2023 and will gradually be introduced after the implementation of the CFTC Rewrite at end of 2022.

Beyond DRR and regulatory reporting, other areas of the derivative trade flow may benefit from the standardisation which CDM offers. Firms will be able to optimise and maximise the automation of internal system interoperability as well as improve external reconciliations leading to a reduction in operational costs. Event management should be simplified if all goes well.

THE REVIEW AND MODELLING OF EMIR FIELDS IS BEING PERFORMED IN PARALLEL WITH THE CFTC EXERCISE, TAKING ADVANTAGE OF COMMONALITY BETWEEN REGULATIONS

OTHER KEY UPDATES

Europe & UK - SFTR

With the announcement of UnaVista closing its SFTR TR at the end of January, those using the service have now migrated over to alternative service providers. The migration has been largely successful, and reporting looks to be continuing with minimal interruption. This has left a large concentration of SFTR reporting at the DTCC TR which should help those grappling with pairing and matching as the regulation continues to mature.

The closing of the UnaVista SFTR TR at the end of January has only added pressure to those who were already having to deal with the new ISO Schema for ESMA and, as reported previously, the need to support two schemas as the FCA delayed their update to the technical message until April. The main changes are to bring the schema, validation rules and guidelines in alignment.

Perhaps the largest individual deliverable for SFTR TRs this year, “Guidelines on the calculation of aggregate named positions in SFTs by Trade Repositories”, is set to be operational later this year. Position Aggregation reporting facilitates high-quality position data necessary for the assessment of systemic risks to financial stability by the relevant authorities. This will bring SFTR into line with EMIR which saw the reporting rolled out in December 2018.

North America - CFTC

Much as expected, there has been communication that the compliance date for CFTC rewrite will be 5th December 2022, hopefully there will be little change to the specification but this remains to be seen. However, it should be noted that SDR’s will still need to implement Part 39 and clearing house reporting will still need to be implemented by May.

A major redlined version of the CFTC specification was published last year (currently 30th September, Version 3.0) and this highlighted some of the difficulties of North American reporting becoming more prescriptive compared to the already more prescriptive ESMA specifications.

THE CLOSING OF THE UNAVISTA SFTR TR AT THE END OF JANUARY HAS ONLY ADDED PRESSURE TO THOSE WHO WERE ALREADY HAVING TO DEAL WITH THE NEW ISO SCHEMA FOR ESMA

Quorsus will continue to monitor the regulatory reporting landscape in 2022 and bring any new developments to you in our Newsletters.

If you would like to discuss more please reach out to our regulatory reporting leads:

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